



**U.S. DEPARTMENT OF INTERIOR**

**OFFICE OF NATURAL RESOURCES REVENUE**

**INDEPENDENT PEER REVIEW OF**

**NORTH DAKOTA STATE AUDITOR'S OFFICE OIL & GAS  
ROYALTY AUDIT DEPARTMENT**

**FOR THE PERIOD JULY 1, 2006 THROUGH DECEMBER 31, 2009**

**October 19, 2010**

INDEPENDENT PEER REVIEW OF  
NORTH DAKOTA STATE AUDITOR'S OFFICE  
OIL & GAS ROYALTY AUDIT DEPARTMENT  
FOR THE PERIOD JULY 1, 2006 THROUGH DECEMBER 31, 2009

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## Independent Peer Review Report

Dennis Roller  
Oil & Gas Royalty Audit Department Manager  
North Dakota State Auditor's Office

We have reviewed the system of quality control for the audit organization of the North Dakota State Auditor's Office Oil & Gas Royalty Audit Department in effect for the selected audit work performed by the Oil & Gas Royalty Audit during the period July 1, 2006 through December 31, 2009. A system of quality control encompasses the Oil & Gas Royalty Audit Department's organizational structure and the policies adopted and procedures established to provide it with reasonable assurance of conforming with *Government Auditing Standards*. The elements of quality control are described in *Government Auditing Standards*. The Oil & Gas Royalty Audit Department is responsible for designing a system of quality control and complying with it to provide reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the Oil & Gas Royalty Audit Department's compliance therewith based on our review.

Our review was conducted in accordance with *Government Auditing Standards* and the Council of Inspectors General on Integrity and Efficiency (CIGIE) guidelines. During our review, we interviewed the Oil & Gas Royalty Audit Department personnel and obtained an understanding of the nature of the audit organization, and the design of the system of quality control sufficient to assess the risks implicit in its audit function. Based on our assessments, we selected engagements and administrative files to test for conformity with professional standards and compliance with the Oil & Gas Royalty Audit Department system of quality control. The engagements selected represented a reasonable cross-section of open and closed royalty audits in the Oil & Gas Royalty Audit Department. Prior to concluding the review, we reassessed the adequacy of the scope of the peer review procedures and met with management to discuss the results of our review. We believe that the procedures we performed provide a reasonable basis for our opinion.

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In performing our review, we obtained an understanding of the system of quality control for the Oil & Gas Royalty Audit Department's audit organization. In addition, we tested compliance with the quality control policies and procedures to the extent we considered appropriate. These tests covered the application of the policies and procedures on selected engagements.

Our review was based on selected tests; therefore, it would not necessarily detect all weaknesses in the system of quality control or all instances of noncompliance with it.

There are inherent limitations in the effectiveness of any system of quality control, and therefore noncompliance with the system of quality control may occur and not be detected. Projection of any evaluation of a system of quality control to future periods is subject to the risk that the system of quality control may become inadequate because of changes in conditions, or because the degree of compliance with the policies or procedures may deteriorate. Section B to this report identifies the engagements that we reviewed.

In our opinion, the system of quality control for the audit organization of the North Dakota State Auditor's Office Oil & Gas Royalty Audit Section in effect for the selected audit work performed during the period July 1, 2006 through December 31, 2009, has been suitably designed and complied with to provide the Oil & Gas Royalty Audit Department with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Tribal and State audit organizations can receive a rating of *pass*, *pass with deficiencies*, or *fail*. The North Dakota State Auditor's Office Oil and Gas Royalty Audit Department has received a peer review rating of *pass with deficiencies*.

*Williams, Adley & Company, LLP*

October 19, 2010  
Washington, D.C.

INDEPENDENT PEER REVIEW OF  
NORTH DAKOTA STATE AUDITOR'S OFFICE  
OIL AND GAS ROYALTY AUDIT DEPARTMENT  
FOR THE PERIOD JULY 1, 2006 THROUGH DECEMBER 31, 2009

**Section A - Summary of Results**

**1. Background**

The Department of Interior Office of Natural Resources Revenue (ONRR) program collects, accounts for, audits, and over the past 5 years has averaged disbursements over \$13 billion annually in revenues from the offshore mineral leases and from onshore mineral leases on Federal and Indian lands.

ONRR collected and distributed over \$200 billion since 1982. The revenues ONRR accounts for are distributed to special-purpose accounts administered by other Federal agencies, the U.S. Department of the Treasury, States, and the American Indian Community. ONRR reviews, analyzes, and audits companies' royalty payments to ensure that they are in compliance with applicable laws, rules, and regulations. Audits are conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS), the ONRR Audit Manual (AM), and applicable policies and procedures. The audit compliance function is headquartered in Lakewood, Colorado, with field offices located in Houston and Dallas, Texas; Oklahoma City and Tulsa, Oklahoma; and Farmington, New Mexico.

ONRR's authority for compliance activities, including audits, is in Sections 101 and 107 of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA), the Federal Oil and Gas Royalty Simplification and Fairness Act (RSFA), the lease terms, and the Federal Regulations at 30 Code of Federal Regulation (CFR) 1201.100 and 1217.50.

**State and Tribal Audits**

The Federal Oil and Gas Royalty Management Act (FOGRMA) authorizes the DOI to enter into cooperative agreements with Indian tribes under section 202 and to delegate audit authority to states under section 205. Under a cooperative agreement, an Indian tribe or state is permitted to conduct inspections, audits, and investigations of activities on their respective Indian or Federal lands. ONRR has cooperative agreements with 10 States and 7 Tribes to conduct compliance audits of Federal and Tribal leases.

## **North Dakota State Auditor Office Oil & Gas Royalty Audit Department**

In accordance with §202 of the Federal Oil and Gas Royalty Management Act of 1982 (P.L. 97-451) as amended, the Secretary of the Interior has authorized ONRR to enter into Delegation of Authority Agreement No. 0205CA40481 with the North Dakota State Auditor's Office Oil & Gas Royalty Audit Department to conduct audits and investigations related to royalty payments made for oil and gas produced and sold from Federal leases located within the borders of the State.

The North Dakota State Auditor's Office Oil & Gas Royalty Audit Department conducts royalty audits on leases producing and selling oil and gas within the boundaries of the State of North Dakota. The North Dakota State Auditor's Office Oil & Gas Royalty Audit Department conducts the audits in accordance with the ONRR Audit Manual (AM) and the *Government Auditing Standards* (2007 Revision), also known as the Yellow Book. The standards require that each organization should have quality control standards implemented and they should also undergo an external quality control review every three years.

The North Dakota State Auditor's Office Oil & Gas Royalty Audit Department has had a cooperative agreement with ONRR to offer oil & gas royalty auditing on the Federal oil and gas leases located within the borders of the State lands since 1985. The most recent agreement started October 1, 2004, with a renewal option through September 30, 2010. The North Dakota State Auditor's Office Oil & Gas Royalty Audit Department recently, signed an additional six (6) year (October 1, 2010 through September 30, 2016) Grant and Cooperative Agreement with ONRR.

### **2. Objective**

The objective of this engagement was to conduct an Independent Peer Review of the North Dakota State Auditor's Office Oil & Gas Royalty Audit Department in accordance with the Government Accountability Office (GAO) *Government Auditing Standards*, 2007 Revision, and the Council of the Inspectors General on Integrity & Efficiency (CIGIE) guidelines under the Inspector General Reform Act of 2008. The peer review considered selected audit work performed by the North Dakota State Auditor Office Oil & Gas Royalty Audit Department during the period July 1, 2006 through December 31, 2009.

### **3. Scope**

The scope was to perform a peer review of selected audits conducted by the North Dakota State Auditor's Office Oil & Gas Royalty Audit Department. We performed detail reviews of audit procedures as identified in the audits selected for review; we also identified control vulnerabilities and problems with the *Government Auditing Standards* compliance. Our review was sufficient in scope to provide us a reasonable basis in determining whether, for the period under review, the North Dakota State Auditor's Office Oil & Gas Royalty Audit Department system of quality control was suitably

designed and whether the North Dakota State Auditor's Office Oil & Gas Royalty Audit Department was complying with its quality control system in order to provide the audit organization with reasonable assurance of conforming to applicable professional standards.

Finally, Williams, Adley & Company LLP (WA) provided a written report detailing our findings, along with recommendations for corrective actions and suggested language for any systemic weaknesses, as appropriate, to the Contracting Officer Representative (COR), the applicable ONRR management and North Dakota State Auditor's Office Oil & Gas Royalty Audit Department principal investigators.

#### **4. Methodology**

WA reviewed the system of quality control of the Oil & Gas Royalty Audit Department in effect for selected audit work performed during the period July 1, 2006 through December 31, 2009. The objective of the review was to determine whether North Dakota State Auditor's Office Oil & Gas Royalty Audit Department internal quality control system was adequate and in compliance with GAGAS in order to provide reasonable assurance that applicable auditing standards, policies, and procedures were met. In analyzing the Oil & Gas Royalty Audit Department's quality control system, we evaluated audit policies and procedures and the following elements for the selected reports reviewed.

WA selected six (6) reports in conformity with guidelines and standards established by the Council of the Inspectors General on Integrity & Efficiency (CIGIE) and Generally Accepted Government Auditing Standards (GAGAS). We tested compliance with ONRR's system of quality control to the extent we considered appropriate. We reviewed and examined supporting working papers; and where required, compared the supporting working papers to CIGIE, GAS, and AICPA audit criteria applicable to ONRR policies and procedures.

#### **5. Peer Review Results**

Based on our peer review procedures of review and verification, except for the deficiencies described below, the system of quality control of the North Dakota State Auditor's Office Oil & Gas Royalty Audit Department, in effect during the period covered, was suitably designed to meet the requirements of the quality control standards established by the CIGIE complied with DOI ONRR to provide reasonable assurance of performing and reporting in accordance with applicable professional auditing standards in all material respects. Agencies can receive a rating of pass; pass with deficiency (deficiencies), or fail. North Dakota State Auditor's Office Oil & Gas Royalty Audit Department has received a peer review rating of pass with deficiencies.

Deficiencies and other conditions that warrant your attention are described in the "Condition and Recommendations" below.

## **Section B - Details of Results**

### **1. Quality Assurance Review Scope and Methodology**

From October 5, 2010 through October 7, 2010 WA conducted a peer review (the review) of the selected audit work performed during the period ending December 31, 2009. We performed the review in accordance with Generally Accepted Government Auditing Standards (GAGAS), Council of the Inspectors General on Integrity & Efficiency (CIGIE) guidelines, and ONRR Audit Manual (AM). We tested compliance with the ONRR's system of quality control to the extent considered appropriate. We randomly selected five (5) audits performed during the period July 1, 2006 to December 31, 2009. Additionally, we made one (1) surprise selection for testing. We reviewed and examined supporting working papers; and where required, compared the supporting working papers to CIGIE, GAS, and AICPA audit criteria applicable to ONRR policies and procedures.

In analyzing the Oil & Gas Royalty Audit Department's quality control system, we evaluated audit policies and procedures and the following elements for the selected reports reviewed. Those elements are: Independence; Professional Judgment; Competence; Audit Planning; Supervision; Evidence and Audit Documentation; Reports on Performance Audits; Non-audit Services; and the Quality Control Process.

### **2. North Dakota State Auditor Office Reports Reviewed**

We visited the North Dakota State Auditor's Office Oil & Gas Royalty Audit Department in Bismarck, North Dakota, and reviewed the following reports and supporting work papers:

<b>Project No.</b>	<b>Report Control Number</b>	<b>Type of Report</b>	<b>Report Date</b>	<b>Name of Reviewed Auditees</b>
1.	04-50079	Performance Audit	1/08/2009	Sinclair Oil Corporation
2.	05-00011	Performance Audit	8/19/2009	Fidelity Exploration and Production Company
3.	06-00069	Performance Audit	2/20/2007	Wilbank Reserve Corporation
4.	08-00504	Performance Audit	7/10/2009	Plain Marketing, LP
5.	09-0013*	Performance Audit	In Progress	Nexen Marketing
6.	05-0008**	Performance Audit	8/12/2009	Whiting Oil & Company

\* Open audit

\*\* Surprise selection



### **3. Conditions and Recommendations**

During the review, we noted one condition that was a deficiency and four that should be brought to management's attention. A full response from the North Dakota State Auditor's Office Oil and Gas Royalty Audit Department can be found in the Appendix of this report.

#### **Finding 1 – No documentation of understanding of auditee's internal control - Deficiency**

There was no documentation in the work papers to support auditor's understanding of auditee's internal control for the six (6) audits reviewed. The audit members did not obtain an understanding of management controls surrounding auditee's systems used to collect, record, process and account for Federal production and royalties to protect the financial interest of the Federal, State, and County beneficiaries.

Section 7.11-7.16 of the Government Auditing Standards, July 2007 Revision states: "Auditors should obtain an understanding of internal control as it relates to the specific objectives and scope of the audit". Internal controls of the entity are the processes for planning, organizing, directing, and controlling the entity's operations. The objective of North Dakota's review of internal controls is to document the systems and the flow of documents through the auditee's organization.

We found that there was a lack of adherence to prescribed accounting and auditing standards, policies and procedures, and non-compliance with the federal guidelines requiring documentation of internal controls. It appears there is confusion between the required understanding documentation of internal control and testing internal control. We noted that this condition is prevalent across the audit universe performed at North Dakota State Auditor's Office.

Failure to document management internal controls surrounding the auditee's system might cause incorrect royalty payments and incomplete information reported to ONRR. There is likelihood of over-auditing or under auditing, therefore resulting in an ineffective audit. This is a significant audit deficiency that could potentially affect the audit results, thus rendering the report unreliable for fulfilling the objectives of the audit.

#### **Recommendation:**

We recommend that the North Dakota State Auditor's Office Oil & Gas Royalty Audit Department management ensures full compliance with the audit requirements as stipulated by both Government Auditing Standards and the ONRR Audit Manual. Further, the manager or supervisor should review audit planning and work papers to include documentation of auditee's internal control. Audit members should be advised to

obtain and document an understanding of auditee's management system of internal control for all audit assignments.

### **Management's Response**

The North Dakota State Auditor's Office Oil and Gas Royalty Audit Department management concurred with this finding. Management stated they will obtain a walk through of company controls surrounding the payment of federal royalties.

### **Auditor Analysis**

We believe that the North Dakota State Auditor's Office Oil and Gas Royalty Audit Department management has addressed the recommendation adequately.

### **Finding 2 – Lack of review and approval of audit program – Condition that needs management attention.**

We noted that the audit program for one of the six (6) audits selected (Whiting Oil & Gas Corporation) was not reviewed or approved by the audit manager. The audit program did not have any reviewer's or approver's signature.

The AM Section 7; *General Lease Audit Programs* requires: For MRM, the audit program must be reviewed and approved by the audit supervisor.

Management did not review the audit to ensure that all items were adequately documented, approved and signed.

Lack of adequate documentation of audit program negatively affects the quality of procedures performed to complete the audit.

### **Recommendation:**

We recommend that the North Dakota State Audit Office Oil & Gas Royalty Audit Department enhance its quality control to ensure that the audit manager or supervisor has reviewed, approved and signed all workpapers.

### **Management's Response**

The North Dakota State Auditor's Office Oil and Gas Royalty Audit Department management concurred with this finding. Management stated the instance noted happened before they were in management and subsequently controls have been put in place to prevent this.

## **Auditor Analysis**

We believe that the North Dakota State Auditor's Office Oil and Gas Royalty Audit Department has addressed the recommendation adequately.

### **Finding 3 – Improper sign off of incomplete audit planning documentation – Condition that needs Management Attention**

The audit plans embedded in one of the six (6) audit work papers did not include audit objectives and there was no reflection of any update or changes made to the plan during the audit. We also noted that the manager approved a planning document before the audit member completed and signed off on it.

The first fieldwork standard for performance audit is: "work is to be adequately planned". In planning, auditors should define the audit objectives and the scope and methodology to achieve those objectives. Based on Section 7.80 of the Government Auditing Standards, July 2007 Revision, auditors must document in the planning the audit objectives, scope, and methodology for the audit. Section 7.50 also requires auditors to update planning to reflect any significant changes made to the plan during the audit. Similarly, the AM 6.4, Audit Plan Development, states that a written audit plan should include documentation of key decisions about the audit objectives, scope, methodology, and of the auditor's basis for those decisions.

The manager did not review the audit plan to ensure the planning document was complete. The manager approved the document but failed to identify the missing objectives in the document.

Failure to document audit objectives in the planning negatively affects the direction, scope, and final conclusion for the audits.

### **Recommendation:**

We recommend that the North Dakota State Auditor's Office Oil & Gas Royalty Audit Department management develop procedures to strengthen review of audit planning documentation to include objectives at the planning phase of an audit. Achieving objectives is necessary for completeness of an engagement.

### **Management's Response**

The North Dakota State Auditor's Office Oil and Gas Royalty Audit Department management concurred with this finding. Management stated the instance noted happened before they were in management and subsequently controls have been put in place to prevent this.

### **Auditor Analysis**

We believe that the North Dakota State Auditor's Office Oil and Gas Royalty Audit Department has addressed the recommendation adequately.

#### **Finding 4 – Audit checklist was not signed off and completed. – Condition that needs Management Attention.**

The audit completion checklist was not completed for one of the six (6) audits (Plain Marketing, L.P.) Reviewed. Also the audit checklist was not signed off for one of the six (6) audits reviewed.

The AM Section 1.6.10; *Closure* states: Prior to closing the case in the case tracking system, the Audit Supervisor must complete an Audit Documentation Checklist. The second-level supervisor or higher manager must review and sign the checklist.

The manager did not ensure audit member sign off and completion of the audit checklist.

Failure by the audit member to sign-off on audit documentation renders the audit work papers incomplete and likelihood of documentation not supporting audit conclusion in the report.

#### **Recommendation:**

We recommend that the manager or designated personnel at the North Dakota State Auditor Office Oil & Gas Royalty Audit Department should review and sign-off on the audit checklist for completeness at the end of each audit.

### **Management's Response**

The North Dakota State Auditor's Office Oil and Gas Royalty Audit Department management concurred with this finding. This was an oversight that has been corrected.

### **Auditor Analysis**

We believe that the North Dakota State Auditor's Office Oil and Gas Royalty Audit Department has addressed the recommendation adequately.

#### **Finding 5 – Audit was not completed within specified timeline – Condition that needs Management Attention.**

In one of the six (6) audits selected (Fidelity Exploration and Production Company), the audit was not completed in a timely manner. The audit started January 28, 2005 and was not completed until August 19, 2009. Fidelity invoked the statute of limitation in complying with the audit findings.

GAGAS section A8.02 states: To be of maximum use, providing relevant evidence in time to respond to officials of the audited entity, legislative officials, and other users' legitimate needs is the auditors' goal. Likewise, the evidence provided in the report is more helpful if it is current. Therefore, the timely issuance of the report is an important reporting goal for auditors.

The audit team did not effectively follow-up with the auditee to provide audit information and document requests in a timely manner. Also, the manager did not take immediate action on the delay by auditee to provide them the audit information and document.

Long delays completing an audit negatively affects the objectives and results of an audit. The audit result may be affected by the statute of limitation against any claims due from auditees should lawsuit arise from the lease contract.

**Recommendation:**

We recommend that the North Dakota State Auditor's Office Oil & Gas Royalty Audit Department develop policies to deal with situation where the auditees delay or fail to provide audit document and information within specified or reasonable timeframes. In addition, the manager should ensure timely start and completion of audits within the audit budget time. Any delay from auditees should be referred to upper management for appropriate action.

**Management's Response**

The North Dakota State Auditor's Office Oil and Gas Royalty Audit Department management concurred with this finding. The delay in the audit was due to a decision by management based on a budget cut that would directly effect the work performed at the office. The audit was subsequently scheduled for a later date.

**Auditor Analysis**

We believe that the North Dakota State Auditor's Office Oil and Gas Royalty Audit Department has addressed the recommendation adequately.

We wish to acknowledge the exceptional assistance and extensive cooperation provided by the North Dakota State Auditor Office Oil & Gas Royalty Audit Department in our performance of the peer review. The work could not have been completed without their full participation and support.

## APPENDIX: Management Comments

STATE AUDITOR  
ROBERT R. PETERSON  
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STATE OF NORTH DAKOTA  
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AUDIT MANAGER  
DENNIS ROLLER  
PHONE  
(701) 250-4602

November 15, 2010

Ms. TaVonna Serious  
Audit Supervisor  
Williams, Adley & Company, LLP  
1250 H Street, N.W.  
Suite 1150  
Washington DC, 20005

Dear Ms. Serious:

This letter transmits the North Dakota State Auditor's Office Royalty Audit Section's response to the draft Peer Review Report. As an overall comment on the peer review, I felt the process was very beneficial and helpful and that Hector Wuor, the peer reviewer, was very knowledgeable of Government Auditing Standards and auditing.

Before I comment on the recommendations of the report, I had a few general comments that really are minor but worth mentioning.

- 1) In the State and Tribal Audits background section the report states that there are 11 states and 7 tribes that have cooperative agreements. ONRR personnel have told me that there are only 10 states as Louisiana no longer has a cooperative agreement.
- 2) In the North Dakota State Auditor Office Oil & Gas Royalty Audit Department background section the report states that we recently signed an additional five (5) year contract for October 1, 2010 through September 30, 2016. That is all correct except that it is a six (6) year agreement as October 1, 2010 through September 30, 2016 is six years.
- 3) In the same section as #2 above the report states (as paraphrased) that we have had a contract with ONRR to do oil and gas audits within the borders of ND since October 1, 2004. While technically correct, I don't believe it tells the whole story. Our previous contract was from October 1, 2004 through September 30, 2010, however our office has had a cooperative agreement with ONRR since 1985. The sentence makes it seem like we have only been doing this work for six years when in fact our

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office has had a cooperative agreement and been doing this work for 25 plus years and all staff of our division have been doing federal mineral royalty audits for more than 15 years each.

- 4) In section 2 of the details of results section, the chart shows the six audits reviewed with a footnote that one of the audits was a surprise audit. In fact, we were provided a list of audits that were to be reviewed prior to the onsite review, but only two of those audits were actually audits reviewed (Plains Marketing and Sinclair Oil). The other audits were replaced after the entrance conference with Hector as they were not an audit (misidentified in ONRRs tracking system), or they were audits in which the report and work was done 5 or more years ago (ONRRs tracking system not being up to date and correct). We discussed, in the entrance conference with Hector, how the ONRR tracking system wasn't accurate and thus these engagements were replaced with the Fidelity Audit, Wilbank Audit and Nexen Audit. So in my opinion, the Fidelity Audit, Wilbank Audit, Nexen Audit and the Whiting Audit were all surprise audits as we had no beforehand knowledge that they would be reviewed.

### Review Recommendations:

- 1) We recommend that the North Dakota State Auditor's Office Oil & Gas Royalty Audit Department management ensures full compliance with the audit requirements as stipulated by both Government Auditing Standards and the ONRR Audit Manual. Further, the manager or supervisor should review audit planning and work papers to include documentation of auditee's internal control. Audit members should be advised to obtain and document an understanding of auditee's management system of internal control for all audit assignments.

Response – I agree. This has been discussed with the ONRR State and Indian Coordination Program Manager and the State will comply with the recommendation by obtaining a basic walk through of the company's controls surrounding the payment of federal royalties. In addition, we have added a statement to our planning document that the walk through will be the only documentation of internal controls.

- 2) We recommend that the North Dakota State Audit Office Oil & Gas Royalty Audit Department enhance its quality control to ensure that the audit manager or supervisor has reviewed, approved and signed all workpapers.

Response – I agree. The one instance of there not being the appropriate signature or approval was the audit program for the Whiting Audit. I agree that the audit program needs to have evidence that it was approved, which is exactly why I put the policy of the audit program being included as an exhibit in the planning document in place shortly after I took over as manager on August 1, 2004. This particular audit planning document was approved on November 2, 2004, prior to this policy being implemented. Prior to August 1, 2004, the federal royalty section did not have any written policies and procedures and thus it took until January 1, 2005 to develop our procedures manual and implement all new procedures.

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- 3) We recommend that the North Dakota State Auditor's Office Oil & Gas Royalty Audit Department management develop procedures to strengthen review of audit planning documentation to include objectives at the planning phase of an audit. Achieving objectives is necessary for completeness of an engagement.

Response – I agree. The one instance of the planning documentation not including objectives at the planning phase of an audit is in the Sinclair audit. The Sinclair audit planning document was not approved by the former manager. The document should have been approved before the engagement letter and data request went out on February 3, 2004. It however was not approved at that time. When I became manager on August 1, 2004, it was brought to my attention and I signed the planning document with a designation of “on behalf of George Staigle”, the prior manager. The audit was almost complete at this time (issue letter were sent in September 2004) and thus we did not modify the planning document, which in retrospect we should have done to include audit objectives. However, I am confident that all planning documents prepared and approved after I became manger do include the objectives of the audit.

- 4) We recommend that the manager or designated personnel at the North Dakota State Auditor Office Oil & Gas Royalty Audit Department review and sign-off on the audit checklist for completeness at the end of each audit.

Response – I agree. The one instance of the audit checklist not being signed is an over sight and mistake by myself. The checklist was completed, was reviewed and I just failed to sign it after the review.

- 5) We recommend that the North Dakota State Auditor's Office Oil & Gas Royalty Audit Department develop policies to deal with situation where the auditees delay or fail to provide audit document and information within specified or reasonable timeframes. In addition, the manager should ensure timely starting and timely completion of audits within the audit budget time. Any delay from auditees should be referred to upper management for appropriate action.

Response – I agree and have two current audits that we are working with the ONRR Office of Enforcement to get the audit documents. However, the one instance the report refers to is the Fidelity audit. The Fidelity audit wasn't delayed due to the client, it was my decision to put the audit off. The Fidelity audit was on the Federal Fiscal year 2005 work plan that was done by the prior manager when our office had six personnel. Then, on September 30, 2004, one day before the start of federal fiscal year 2005 and 60 days after I became the manager, the ONRR informed me that they were cutting our budget almost in half. Ultimately we ended up with 4 positions instead of 6 which caused a back log of work (work plan was developed assuming 6 positions). Thus, I decided that the Fidelity audit would be put off as I felt it was the least likely to have a collectible issue. Ultimately, this audit wasn't delayed by Fidelity, it was delayed by my decision of which audits we would do first due to a



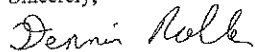
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reduction in staff which resulted in the Fidelity audit being worked on in a piece meal fashion when the auditor had time from her other audits.

Sincerely,

A handwritten signature in cursive script that reads "Dennis Roller".

Dennis Roller  
Audit Manager  
ND Auditor's Office – Royalty Audit Section